UNITED STATES DEPARTMENT OF AGRICULTURE
FARM CREDIT ADMINISTRATION
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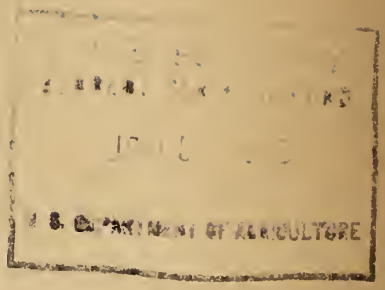

SUMMARY OF CASES

RELATING TO

FARMERS' COOPERATIVE ASSOCIATIONS

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NO MANDATORY OBLIGATION - THEREFORE REFUNDS NOT EXCLUDABLE

The case of Associated Grocers of Alabama v. Willingham, 77 F. Supp. 990, was brought against the Collector of Internal Revenue for the State of Alabama to recover income and excess profit taxes that had been paid under protest. Apparently, the only issue involved in the case was whether "so-called 'patronage dividends' or refunds of profits paid by the company to its membership certificate holders, in proportion to their trading operations with the company and without regard to the amount of stock held by the distributees of such refunds," are excludable.

The court said:

> "The plaintiff does not claim that it is exempt from taxation, but contends that the amounts distributed to stockholder patrons and member patrons are not properly includable in its taxable income, because of the nature of its organization and the operation of its business, in that the refunds distributed were allowable as proper business expenses.
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> "For the plaintiff to recover, it must be established that there was an obligation by the corporation to make refunds or rebates to member patrons when the incomes for the respective years were received by the corporation. Peoples Gin Co., Inc. v. Commissioner of Internal Revenue, 5 Cir., 118 F. 2d 72.
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> "Such an obligation must arise from the association's articles of incorporation, its by-laws, or some other contract, and must not depend upon some corporate action taken after its receipt of the money later distributed, such as the action of the corporation's officers or directors. (Underscoring added.)

The court considered the bylaws of the association and its charter for the purpose of ascertaining if the association was under a mandatory obligation to make the refunds. In this connection, the court said:

> "Consideration is first given as to whether there was an obligation arising under the by-laws or charter of the corporation. The amendment of the corporation's bylaws on April 8, 1941, was mandatory in its requirement to credit to the outstanding certificates of membership, based upon the trade operations of the corporation with the owner and holder of the certificate, any profits after deducting therefrom any amount necessary for improvements, expansions or operating capital. The amendment to the corporation's certificate of incorporation on April 15, 1941, was not mandatory in its provisions but, to the contrary, left it within the discretion of the Board of Directors to return to the owners and holders of certificates of membership any profits earned by the corporation during the preceding fiscal year, such refunds being evidenced by patronage dividend certificates or preferred stock, in the discretion of the certificate holder, or in cash in the sole

discretion of the Board of Directors. The returns of such profits thereby authorized were to be based upon the trading operations for that year. (Underscoring added.)

It is submitted that the view of the court that the bylaws constituted a firm obligation to make refunds is a liberal one. It is questioned whether all courts would take the same view. Under the bylaws referred to, the board of directors had the authority to use all the excess over and above operating and maintenance costs and expenses for "operating capital" and other purposes, and of course, in the event this was done, there would be nothing to distribute as patronage refunds. The option and discretion which the board of directors had under the bylaws to use the excess "for improvements, expansions, or operating capital" raises a serious doubt as to whether the association was obligated to make any refunds at all. As stated in the foregoing quotation, the court held that the amendment to the certificate of incorporation of the organization, effective April 15, 1941, left the matter of making refunds to the discretion of the board of directors, and therefore the court held that the refunds which had been made could not be excluded or deducted in computing the income taxes of this nonexempt organization. In this regard, the court said:

> "Since there was no enforceable obligation on the part of plaintiff corporation under its charter and valid by-laws to refund profits to its membership certificate holders at the time the income was received, it follows that plaintiff is not entitled to a deduction on the basis of profits eventually refunded." (Underscoring added.)

The plaintiff argued that it was under an obligation to make refunds by virtue of letters which it had sent to its stockholders and prospective stockholders, which held out that such refunds would be made. Regarding this matter, the court said:

> "Under the further facts set down in the stipulation that the 'certificate holders and stockholders relied on the representations and promises made in said letters and undertakings in said by-laws to distribute patronage dividends in accordance with the said by-laws and were induced thereby to increase their trading operations with the company,' I would be constrained to hold that there was a binding obligation, as between the corporation, and the stockholders of the corporation and those who were induced to become stockholders, thereby to pay such rebates were it not for the amendment to the articles of incorporation effective April 15, 1941. Certainly the stockholders who adopted this resolution were charged with notice of the change in provisions and authority as set forth in the amendment to the articles of incorporation, which amendment was duly recorded, and there would attach to and become incorporated in any such agreement those pertinent provisions of the amendment to the articles of incorporation which left the refund of profits within the discretion of the Board of Directors." (Underscoring added.)

As shown in the foregoing quotation, the court was of the opinion that representations made in the letters which were sent to the stockholders and prospective stockholders would have constituted an obligation to make refunds if it had not been for the amendment to the articles of incorporation which became effective April 15, 1941, and which gave the board of directors discretion with respect to the making of refunds. It is of course a general rule of law that the stockholders of a corporation are charged by law with knowledge of all provisions contained in its articles of incorporation. There is also another fundamental rule of law that provisions in bylaws must be consistent with the articles of incorporation and that any bylaws in conflict therewith are ineffective. If there is a conflict, the articles of incorporation control. Therefore, mandatory provisions in bylaws, to be effective, must be consistent with the articles of incorporation and the statute under which the association is incorporated.

The court further said:

> "Clearly, in my mind, there was no obligation to make a refund of profits based on trading operations or patronage dividends, by whatever name they may be called, that would have been enforceable in a court of law had the Board of Directors declined to declare the refund of profits or patronage dividends. Under such circumstances, the corporation was not entitled to deduct the refund of profits either for the year 1941 or 1942. American Box Shook Export Ass'n v. Commissioner of Internal Revenue, supra.
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> "I have given serious consideration to the case of Uniform Printing & Supply Co. v. Commissioner of Internal Revenue, 7 Cir., 88 F. 2d 75, 76, 109 A.L.R. 966, cited and relied on by the plaintiff. The pertinent bylaw in the Uniform Printing and Supply Company case provided: 'The decision of the Board of Directors as to the percentage and/or amount to be returned to each customer shall be conclusive.' This provision was made in connection with the first portion of the by-law providing that all of the surplus earnings not, in the opinion of the Board of Directors, required in the conduct and/or expansion of the business of the corporation should be returned to the customers. In that case, however, there was an obligation to make refunds under the by-laws but the amount payable was contingent on the decision of the Board of Directors as to the amount of reserves required in the conduct of the corporation's business. In this case, the very obligation itself to make such refunds depends upon the discretion of the Board of Directors." (Underscoring added.)
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> "But for the ineptitude of the draftsman of the amended certificate of incorporation (who was not plaintiff's distinguished counsel), the plan would have achieved its objective. However, it is not the function of the courts to compensate for such

mistakes or to declare that what was done, though through ignorance, was a substantial injustice. The language of Judge Hutcheson in Jeffries v. Commissioner of Internal Revenue, 5 Cir., 158 F. 2d 225, 226, is peculiarly appropriate to the situation obtaining here."

With respect to the Uniform Printing & Supply Company case discussed above, it is believed that the so-called obligation that the court found to exist in this case was not as firm and definite an obligation as an association should have that desires to be in a position where it may exclude patronage refunds which it makes. It is believed that the formula or rule embodied in the articles of incorporation, the bylaws, or a contract should be so specific that any competent accountant having access to the books and records of an association could apply the formula or rule and ascertain the amount of the patronage refund to which any patron might be entitled without any action by the board of directors.

For other cases bearing upon this matter see: American Box Shook Export Ass'n v. Commissioner of Internal Revenue, 9 Cir., 156 F. 2d 629; Summary No. 31, p. 7; United Cooperatives, Inc., Petitioner, v. Commissioner of Internal Revenue, Respondent, 4 T. C. 93; Summary No. 24, p. 1; Fruit Growers Supply Co. v. Commissioner of Internal Revenue, 9 Cir., 56 F. 2d 90.

SPEECH BY DEPUTY COMMISSIONER EDWARD I. McLARNEY

The following quotation is taken from the address entitled "A Glance at Some Tax-Exempt Organizations," by Deputy Commissioner Edward I. McLarney of the Bureau of Internal Revenue, given on September 26, 1948:

"To be recognized as a true cooperative, all profits or savings remaining after the payment of such authorized dividends on stock must be turned back or credited to the patrons, whether members or not, of the association, solely on the basis of the amount of produce marketed or supplies purchased through the organizations. Any discrimination in this respect will deprive the organization of exemption under the law.

"An association will not be denied exemption merely because it markets the produce of nonmembers, but section 101(12) contains a limitation which contemplates that if a cooperative markets the products of both members and nonmembers, the products sold for its members must equal or exceed in value the products sold for nonmembers. Where supplies are purchased for nonmembers there is an additional limitation that the value of such purchases made for persons who are neither 'members' nor 'producers' shall not be more than 15% of the total value of all purchases made.

"In figuring the limitation on non-membership business, the word, 'value' means 'gross value' rather than 'net value'. An oil refinery furnished petroleum fuels and other products to some farmer patrons who lived so far away from it that it preferred

to sell its products near by and then make replacement purchases at points nearer to these patrons, and it wished to figure the limitation only on the final sales of the replacements, whereas the Bureau held that the sales in the open market should be treated as nonmember nonproducer business even though the proceeds were used to make replacement purchases at some other point. There are cases where such replacement sales may range from 25% to 30% of the total output of the refinery, and if the products sold on the open market exceed 15% of the total sales to all patrons, the cooperative will lose its exemption.

"An interesting example of the limitation that nonmember business may not exceed member business occurred in the case of a farmers' produce market which rented space both to producer-members of the cooperative marketing organization, and to nonmembers who produced other products that were considered desirable to attract buyers to the market. The rental of facilities for the sale of shipped-in produce actually resulted in a large loss to the cooperative. Tax-exemption was denied, however, for the reason that the gross rentals received from nonmembers exceeded the gross rentals received from members, and therefore the cooperative could not comply with the necessary condition for exemption.

"Some cooperatives which were exempt during the period of their operations received a shock when they came to dissolve and distribute to their members the profits realized on the sale of the assets. They discovered that exemption from income tax comes to an end on the day the cooperative ceases operations, and that when it sells its assets and ceases to operate, its exempt status is terminated and it is required to file income tax returns including therein the profits realized on the sale of the assets.

"In 1944 there were some 280,000 exempt organizations, compared with 225,000 in 1947. By Dec. 31, 1947, information returns on Form 990 had been filed by 103,623 organizations. Most of those which did not file are excused by law from filing, such as churches, ordinary schools and colleges, charitable organizations supported by the public or by governmental funds, fraternal beneficiary societies such as the Masons, Odd Fellows and Knights of Columbus, and agencies wholly-owned by the United States Government." (Underscoring added.)

EMPLOYMENT TAXES - WHO ARE EMPLOYEES?

In the case of Fahs v. Tree-Gold Co-op. Growers of Florida, 166 F. 2d 40, it appeared that Tree-Gold Co-op. Growers of Florida, Inc., and Gentile Brothers Company each brought actions against John L. Fahs, Collector of Internal Revenue, to recover money paid by them as employment taxes under the Social Security Act. The actions were consolidated. The District Court held in favor of the plaintiffs on the theory that the employment taxes which the plaintiffs had been required to pay had been paid on account of work done by independent

contractors, and because of this fact, the individuals in question did not have the status of employees. It appeared that it is the custom of persons having citrus fruit to pack, to receive bids from persons desiring to contract for the season, which lasts only three or four months, "to construct the boxes, which are shipped to a packing house knocked down, and to label and load them into cars after they are packed, for so much per hundred boxes. This custom antedated the social security laws, and was not an effort to circumvent them."

The Circuit Court of Appeals reversed the finding of the District Court and held that the persons in question were employees within the meaning of the Social Security Act. The following quotation from the opinion in the case shows the basis thereof:

> "We need not now decide whether the facts as found by the court below upon the question of control, when taken with the other circumstances of the employment, are sufficient to require an ultimate finding that the persons were employees; because the Supreme Court, in a series of recent decisions, has announced the view that coverage under the Social Security Act should be determined on the basis of the rationale applied by it in cases involving the Fair Labor Standards Act of 1938, 29 U.S.C.A. 201 et seq., and the National Labor Relations Act, 29, U.S.D.A. 151 et seq. Under this view, while recognizing that it is an element characteristically associated with the employer-employee relationship and to be considered, the question of control is not the sole or determining factor. The ultimate criteria are to be found in the purposes of the act.
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> "Under these decisions, the act is intended to protect those whose livelihood is dependent upon finding employment in the business of others. It is directed toward those who themselves are least able in good times to make provisions for their needs when old age and unemployment may cut off their earnings. The statutory coverage is not limited to those persons whose services are subject to the direction and control of their employer, but rather to those who, as a matter of economic reality, are dependent upon the business to which they render service.
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> "From the facts disclosed in the record, we are of opinion that the services in question constituted a part of an integrated economic unit devoted to the packing of citrus fruit and fruit products." (Underscoring added.)

In the dissenting opinion, it is said:

> "Bradford, Walker and Hobbs were the low bidders at taxpayers' packing house, and received contracts for all or a part of these jobs in the above named shipping seasons. They could not by themselves execute the work each had contracted for, but each hired other men to aid in the work or to do it all, as they desired, the taxpayers having nothing to do with the hiring, control or discharge

of them, and paying them no wages and owing them none. When eight or more were used by a contractor, he recognized that he was an employer under the social security laws and paid his and their social security taxes accordingly. The packing house had no legal relation to these workmen except, being the owner of the portion of the premises assigned for doing this work, it was bound to see that the premises were reasonably safe. Bradford, Walker, and Hobbs paid the wages of their several workmen, less their taxes, out of what they received in the weekly settlements for boxers made or loaded under their respective contracts; they paid their own taxes, and what was left was the season's profit.

"The taxes in dispute, however, were assessed on all that was paid Bradford, Walker, and Hobbs, although the greater part of it went to their workmen and some of it went for social security taxes due by Bradford, Walker, and Hobbs as being themselves employers. It seems to me unjust and self-contradictory to say these three men are employees and what is paid them is taxable wages, and at the same time to say they are employers and as such owe taxes on the greater part of what was paid them. This fact of their being bona fide employers of others on their own account and not as agents of the plaintiffs here is what distinguishes this case from those recently decided by the Supreme Court."

It would seem that this decision is so broad as to virtually make it impossible for any person to have the status of an independent contractor from the standpoint of the Social Security Act, prior to its amendment on October 1, 1948 (Public Law 642, 80th Congress), discussed in the next article. Persons who function as independent contractors are employed by others. In fact, it is the terms and character of the employment that ordinarily determine if persons are employed as independent contractors or as employees.

SOCIAL SECURITY ACT AMENDMENT - INDEPENDENT CONTRACTORS

Public Law 642, 80th Congress, amended the Social Security Act by defining an independent contractor as "any individual who, under the usual common-law rules applicable in determining the employer-employee relationship, has the status of an independent contractor." This definition is retroactive to the date of the enactment of the respective acts. The following quotation is taken from this amendment:

"Resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) section 1426 (d) and section 1607 (i) of the Internal Revenue Code are amended by inserting before the period at the end of each the following: ', but such term does not include (1) any individual who, under the usual common-law rules applicable in determining the employer-employee relationship, has the status of an independent contractor or (2) any individual (except an officer of a corporation) who is not an employee under such common-law rules'.

"(b) The amendments made by subsection (a) shall have the same effect as if included in the Internal Revenue Code on February 10, 1939, the date of its enactment.

"Sec. 2. (a) Section 1101 (a) (6) of the Social Security Act is amended by inserting before the period at the end thereof the following: ', but such term does not include (1) any individual who, under the usual common-law rules applicable in determining the employer-employee relationship, has the status of an independent contractor or (2) any individual (except an officer of a corporation) who is not an employee under such common-law rules'.

"(b) The amendment made by subsection (a) shall have the same effect as if included in the Social Security Act on August 14, 1935, the date of its enactment, but shall not have the effect of voiding any (1) wage credits reported to the Bureau of Internal Revenue with respect to services performed prior to the enactment of this Act or (2) wage credits with respect to services performed prior to the close of the first calendar quarter which begins after the date of the enactment of this act in the case of individuals who have attained age sixty-five or who have died, prior to the close of such quarter, and with respect to whom prior to the date of enactment of this Act wage credits were established which would not have been established had the amendment made by subsection (a) been in effect on and after August 14, 1935."

In the report (No. 1255) of the Committee on Finance of the Senate on H.J. Res. 296, which became Public Law 642 of the 80th Congress, will be found quite a comprehensive discussion of the reasons for the amendment. In this report, it is stated that:

"The joint resolution would reaffirm the unbroken intent of Congress that the usual common-law rules, realistically applied, shall continue to be used to determine whether a person is an 'employee' for purposes of applying the Social Security Act." (Underscoring added.)

AGRICULTURAL LABOR - EMPLOYMENT TAXES

In Stromberg Hatchery v. Iowa Employment Security Commission, decided by the Supreme Court of Iowa, 33 N.W. 2d 498, that Court held that under the Iowa Employment Security Law, which, in the particulars in question, is identical with the Federal Social Security Act, the term "agricultural labor" included all the employees of a hatchery, including the workers who were not directly identified with the manual process of incubating chicks. The opinion of the Court follows:

"The Iowa Employment Security Law proclaims its purpose of 'encouraging employers to provide more stable employment and by the systematic accumulation of funds during periods of employment to provide benefits for periods of unemployment.' Section 96.2, Code 1946.

"This 'encouragement' is accomplished by establishing a special fund to be administered by the commission (Code section 96.9) and by requiring contributions thereto by the employer 'on all taxable wages.' Code section 96.7. Benefits to employees are payable from this fund during periods of unemployment. The rules governing such payments and eligibility therefor are worked out in detail but need not be discussed here. See Code sections 96.3 et seq.

"The question in the instant case is whether plaintiff, as to certain of its employees, is within the terms of the act requiring contribution to this special fund. It operates a poultry hatchery in the city of Ft. Dodge. Its 12 or 14 employees include salesmen, cullers, testers, office clerks, office manager, chick sexer, incubator watcher, incubator operator, and a handyman.

"Plaintiff claims all those employees (all admittedly necessary to the conduct and operation of its business, though not all 'actually engaged in the manual process of incubating chicks') are within the statutory exclusion of 'agricultural labor' from the operation of the act, which defines 'agricultural labor' to include 'all services performed * * * in connection with the hatching of poultry.' Code section 96.19, subd. 7, par. g(4).

"The defendant Commission on the other hand held, and argues here, that 'the agricultural exemption refers to services and does not purport to exempt all employees in appellee's (plaintiff's) commercial enterprise'; that is, whether there is coverage depends on the nature of the services rendered by the employee and is not governed alone by the fact that the business of the employer is 'the hatching of poultry' and that the services are necessary to that business.

"The trial court reversed the decision of defendant Commission which brings the question to us by appeal.

"I. The formal set-up of the statute is as follows: Chapter 96 is titled 'Employment Security.' Section 96.19 is devoted to 'definitions' and subsection 7 thereof deals with the term 'employment.' This subsection has seven divisions lettered from a to g, inclusive. Subsection 7-g enumerates the services the term 'employment' does not include and contains numbered paragraphs (1) to (8) inclusive. Paragraph (4) thereof, so far as deemed material here, is as follows:

"'(4) Agricultural labor. The term "agricultural labor", as used in this chapter includes all services performed:

"'On a farm, in the employ of any person, in connection with cultivating the soil, or in connection with raising or harvesting any agricultural or horticultural commodity, including the raising, shearing, feeding, caring for, training, and management of livestock, bees, poultry, and fur-bearing animals and wildlife.

"'In the employ of the owner or tenant or other operator of a farm, in connection with the operation, management, conservation, improvement, or maintenance of such farm, its tools and equipment, or in salvaging timber or clearing land of brush and other debris left by a hurricane, if the major part of such service is performed on a farm.

"'In connection with the production or harvesting of maple sirup or maple sugar or any commodity defined as an agricultural commodity in section 15(g) of the federal agricultural marketing act, as amended, or in connection with the raising or harvesting of mushrooms, or in connection with the hatching of poultry, or in connection with the ginning of cotton, or in connection with the operation or maintenance of ditches, canals, reservoirs or waterways used exclusively for supplying and storing water for farming purposes.'

"We have italicized the references to poultry in the foregoing three unnumbered subparagraphs of paragraph (4). There are three more unnumbered subparagraphs not deemed material here. The purpose of setting out the full text of the first three is to present the language, 'all services performed * * * in connection with the raising * * * of poultry,' in its correct context. It will be observed each subparagraph is separate and relates back to the words 'The term "agricultural labor" * * * includes all services performed.'

"It should be said at this point that the statutory language quoted above is identical with the corresponding part of the federal Social Security Act as amended August 10, 1939. See 26 U.S.C.A. Int. Rev. Code, § 1426(h), (1), (2), (3). Prior to that amendment the term 'agricultural labor' was not defined in that Act. See Historical Note 26 U.S.C.A. Int. Rev. Code, § 1426, page 378; Birmingham v. Rucker's Imperial Breeding Farm, 8 Cir., 152 F. 2d 837, 839. Prior to that time also our own statute contained no such definition. Code 1939, section 1551.25G; 50 G.A. Ch. 77, pars. (a), (b) and (c). The definition was added to our statute in 1943.

"Considering the sequence in time and the identity of language we must conclude the amendment to our own statute was for the definite purpose of conforming it to the Congressional intent expressed in the Amendment of August 10, 1939, to the Social Security Act. It is of course the intent of our own legislature that controls. But in seeking that intent we have no guide post except the inevitable assumption that the legislature intended just what Congress intended by the language employed.

"Had the language been borrowed from the statutes of a sister state we would go for light to the construing decisions, if any, of that state. Such decisions would not be conclusive on us, especially if not rendered before our legislature adopted the language in

question. But even subsequent decisions in the jurisdiction where the legislation originated would be entitled to unusual respect and deference. 50 Am. Jur., Statutes, § 323; 59 C.J. 1065 (§§ 627, 628). This is especially true of the statute involved here which was devised by Congress as a model of uniform social legislation to be adopted by the state legislatures.

"II. The identical language of the federal statute has been construed by the Circuit Court of Appeals of the 8th circuit contrary to the contention of appellant Commission here. In Birmingham v. Rucker's Imperial Breeding Farm 8 Cir., 152 F. 2d 837,840, it was held that services essential to the operation of a hatchery, although not performed in incubation of eggs, constituted 'services performed * * * in connection with the hatching of poultry' within the statutory definition of 'agricultural labor' in the federal act. That decision affirmed the decision of the United States District Court of the Southern District of Iowa 63 F. Supp. 779.

"The opinion, after referring to departmental rulings to the contrary, says: 'Concededly, Congress was concerned with relieving agriculture of the social security tax burden by including in the term "agricultural labor" certain services which had been held not to be exempt, but which were considered to be in reality an integral part of farming activities.' (Citing records of Congressional proceedings.) 'It seems clear that Congress, in defining "agricultural labor," used the broad language * * * advisedly and in the realization that the burden of taxes imposed upon hatcheries which procured their eggs from farmers and sold their chicks to farmers would have to be borne by agriculture. If Congress had intended that agriculture should be relieved of this tax burden only to the extent of the taxes upon wages paid to those rendering services in the incubation of eggs, it would, we think, have selected appropriate language to express that intent.'

"III. This is persuasive reasoning. Adding to it is at the risk of over-emphasis. However, we find internal evidence in the language of the statute itself pointing to the same construction. In the first unnumbered subparagraph of paragraph (4) heretofore quoted it is definitely provided that services performed by an employee on a farm in connection with raising or harvesting any agricultural commodity, 'including the raising, * * * feeding, caring for * * * and managment of * * * poultry' is included in the term 'agricultural labor.' This language expressly covers poultry raising as a farming operation.

"The subsequent language in the third unnumbered subparagraph, 'in connection with the raising of poultry,' is entirely unnecessary therefore unless intended to include in the definition services performed, not on a farm and in connection with farming operations, but elsewhere in the conduct of a new kind of business that is not farming, but intimately related to agriculture. Whoever devised this language--whether Congress or legislature--must have

intended to add something to what had been already enumerated. We should not treat the language as superfluous or as surplusage. (Underscoring added.)

"The purpose of the exemption or exclusion of 'agricultural labor' from the Employment Security Law was surely not to exclude a certain class of employees from the benefits of social security legislation. Presumably an unemployed farm laborer suffers just as much as any other unemployed workman and his unemployment is just as serious a threat to our economy as is any other involuntary idleness. He is not excluded from the benefits because of any lack of merit in himself but because of the unwillingness of Congress and the legislature to burden the industry in which he is engaged. That seems a necessary conclusion. And if it be assumed, as we think it must, that the purpose here was to broaden the definition of agriculture to include commercial hatcheries, there seems no reason or logic in construing the language to exempt the wages of certain hatchery employees, while taxing the wages of others. (Underscoring added.)

"There is other internal evidence pointing to the conclusion that the term 'agricultural labor' was not intended to be limited to labor that was strictly agricultural in character or related directly to farming operations.

"In both the first and second unnumbered subparagraphs of paragraph (4) which we have set out in full, and in the fourth which we have not quoted, it is made clear the services described are those performed on farms or those directly related to farming operations. In the fourth, which refers to activities not in their nature so closely related to actual farming, it is expressly provided; 'but only if such service is performed as an incident to ordinary farming operations or, in the case of fruits and vegetables, as an incident to the preparation of such fruits or vegetable for market. The provisions of this paragraph shall not be deemed to be applicable * * * to service performed in connection with commercial canning * * *.'

"The third unnumbered subparagraph with which we are concerned here contains no such limiting language to exclude commercial enterprises. The fact that it does not and that the other subparagraphs do is significant of the intent of the legislative bodies.

"We find no decision precisely in point except the Birmingham case above discussed. However there are two cases cited therein in which the same court construed language of the Fair Labor Standards Act, 29 U.S.C.A. § 201 et seq., somewhat analogous to the language we are considering. Se Miller Hatcheries v. Boyer, 8 Cir., 131 F. 2d 283, and Walling v. Rocklin, 8 Cir., 132 F. 2d 3. They illustrate the tendency of that court toward a broad construction of the term 'Agriculture' as used and defined in recent federal social legislation. The language of the 'Fair

Labor Standards Act' is set out in foot note to the Miller Hatcheries case [131 F. 2d 284] and the court points out that the Administrator of the Wage and Hour Division has consistently interpreted the operation of a commercial hatchery to constitute 'the raising * * * of poultry' and holds that employees engaged in the necessary incidents of these operations are therefore 'employed in agriculture.'

"It should be pointed out that two of the federal cases cited by appellant as tending to support its contention were decided under the Social Security Act as it stood prior to the Amendment of August 10, 1939. See Jones v. Gaylord Guernsey Farms, 10 Cir., 128 F. 2d 1008, and Larson v. Ives Dairy Co., 5 Cir., 154 F. 2d 701. Another cited case affords no particular comfort to appellant. United States v. Navar, 5 Cir., 158 F. 2d 91. Miller v. Burger, 9 Cir., 161 F. 2d 992, also cited, involved services performed in what the court held to be a 'terminal market' within the meaning of the paragraph of the Social Security Act identical with the fourth unnumbered subparagraph of section 96.19, subd. 7, par. g-(4) of our statute. It is not in point here.

"IV. The interpretation we place upon the phrase in 'connection with' is not strained or without precedent. In Wallrabenstein v. Industrial Commission, 195 Wis. 15, 216 N.W. 495, the court construed an insurance coverage of 'all employees of whatever nature * * * engaged upon or in connection with such farm,' to include a household domestic: 'The service performed by appellant in caring for the farm home of her employer was clearly a service necessary to be performed in connection with the farm * * *.' (Italics supplied.) The court said it was significant that the coverage was not limited to labor 'engaged upon' the farm. It also said an express exclusion of 'clerical office force' referred to a class of employees which would otherwise have been included in the phrase 'in connection with.'

"In Gurney v. Atlantic & G.W.R. Co., 58 N.Y. 358, it was held that a court order directing a receiver to pay wages for labor performed 'in connection with that Company's railways' was intended to embrace every service rendered in promoting the interest and enforcing and defending the rights of the company in respect to its railways in its possession and under its management.

"Doubtless the language must be construed in the light both of its context and its purpose. This we have tried to do. We think the sound reasoning of the Birmingham case and the considerations we have pointed out require an affirmance of the trial court's decision and it is so ordered."

The reasoning of the Court would appear to apply equally to all labor performed in connection with any of the other activities, in addition to the hatching of poultry, which are enumerated in the definition of "agricultural labor" performed "in connection with the production or harvesting of maple sirup or maple sugar or any commodity defined as

an agricultural commodity in section 15(g) of the federal agricultural marketing act, as amended, or in connection with the raising or harvesting of mushrooms, or in connection with the hatching of poultry, or in connection with the ginning of cotton, or in connection with the operation or maintenance of ditches, canals, reservoirs or waterways used exclusively for supplying and storing water for farming purposes."

A FEW LEGAL OBSERVATIONS 1/

There are those who are of the opinion that agricultural cooperative associations are above the law and independent thereof; and that they are not subject to the law the same as other comparable business concerns. I want to emphasize that this view is incorrect, and I want to stress that agricultural cooperative associations are subject to the law the same as other business enterprises. This means that the legal problems of cooperatives are in general the same as those of other comparable business concerns.

There is a myth that agricultural cooperative associations are not subject to the antitrust acts.2/ The view that they are exempt from such statutes is widespread and deep-rooted, but it is a false conception. The Capper-Volstead Act3/ does not and was never intended to exempt cooperative associations from the antitrust acts. It does authorize, if any authorization is necessary, the formation of associations, including the marketing contracts which they may enter into with their members, but after such associations are organized, in their business operations they are just as amenable to the antitrust acts as all other business entities.

Before the enactment of the Capper-Volstead Act, it was believed that the elimination of the competition among farmers, which takes place when they form and enter into marketing contracts with a cooperative association for the handling and marketing of their agricultural commodities, constituted a violation of the antitrust acts. There were instances in which some farmers' organizations were prosecuted on this theory. In order to resolve any doubt regarding the right of farmers to organize and to eliminate the competition among them which takes place when farmers form and contract to market their agricultural commodities through an association, the Capper-Volstead Act was passed. The title of this Act well disclosed its purpose. It is "An Act to authorize association of producers of agricultural products." Note the words, "authorize association." That is exactly what the Act was intended to do, and that is all the Act does.

If it had been intended that this Act would exempt agricultural cooperative associations from the antitrust laws, the title would have been something like this: "An Act to exempt associations of producers of agricultural products from the antitrust acts."

1/ Based on a talk given by Lyman S. Hulbert at Raleigh, North Carolina, on October 6, 1948.
2/ 15 U.S.C. 1 et seq.
3/ 7 U.S.C. 291.

The Capper-Volstead Act simply operates to enable farmers to form marketing cooperative associations for the handling and marketing of their agricultural commodities just as businessmen may pool their resources to form and operate large industrial corporations. In order to enable farmers to obtain the advantages of mass production and mass marketing, no one would want them to be required to turn their farms over to a large corporation which would engage in farming. All interested in preserving the American way of living believe that the family-size farm contributes materially to that way of life. Now, by means of large cooperative associations, producers may obtain the advantages of large-scale operations while retaining the independent ownership of their individual farms. We do not insist upon individual businessmen operating individual businesses, but by common consent it is accepted that they may form large industrial corporations through a pooling of their capital. And these industrial corporations are not by reason of their existence a violation of the antitrust acts. All that agriculture was seeking in the enactment of the Capper-Volstead Act was authority for the formation of associations of farmers that might to a small degree at least parallel the large industrial corporations which could be formed without any special act of Congress to authorize their formation. As previously stated, however, after an association is formed, it must conform to the same rules and restrictions as other comparable concerns.

Almost no violations of the antitrust laws arise solely by reason of the formation of corporations, but they do arise from contracts, agreements, and arrangements which are made after the organization of the corporations.

If a contract or arrangement is entered into by a cooperative association with third persons or with the buyers of its products which would be a violation of the antitrust laws if entered into by any other business concern under comparable conditions, it would be a violation of the antitrust laws insofar as the cooperative association is concerned.

In 1934, a statute 4/ known as the Fishermen's Collective Marketing Act was passed. It is similar to the Capper-Volstead Act. In an antitrust case 5/ involving an organization of independent fishermen, it was held that this cooperative association of fishermen could not legally enter into a contract which restricted the buyers to purchasing only from fishermen who were members of the organization and barred the buyers from buying from others, with no agreement on the part of the organization to furnish the buyers with all the fish they might need. The court held that such a contract would constitute a violation of the antitrust laws. Of course, under such a contract a purchaser of fish was not assured of receiving any fish at all, and yet he was barred from buying from others. It is believed this type of contract is invalid regardless of the type of organization which may desire to enter into the same. Illustrations could be multiplied of other ways by which the antitrust laws may be violated. For instance, the Supreme Court of the

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4/ 15 U.S.C. 521.
5/ Columbia River Packers Ass'n v. Hinton, 34 F. Supp. 970, 974.

United States held recently that the International Salt Company 6/ had violated the antitrust laws by entering into agreements with dealers which barred the dealers from using in machines leased or purchased from the International Salt Company any salt purchased from anyone other than the International Salt Company. Of course, a cooperative association under comparable conditions would be subject to the same restrictions.

The Robinson-Patman Act 7/, which was enacted to prevent price discriminations, is just as applicable to a cooperative association as to any other business concern. In fact, a few cooperative associations have found themselves in serious difficulties because of violations by them of the Robinson-Patman Act.

The key to an understanding of this Act is the fact that it was intended to place small buyers in the making of their purchases on a basis of substantial equality with large buyers. It is administered by the Federal Trade Commission. The Robinson-Patman Act does not require any seller to sell commodities to anybody. Sellers are free to choose their customers, but on the other hand, if a seller in interstate or foreign commerce elects to sell commodities to a buyer, he must not discriminate in price or otherwise against such buyer, at least if to do so would adversely affect such commerce.

Quantity discounts as such are barred by the Robinson-Patman Act. At one time, a seller was free to give a discount based entirely on the fact that the buyer was taking a carload or a number of carloads of a particular commodity. Thus, a large buyer could obtain a substantially better price than could a buyer who bought, for instance, only half a carload. Now, if a seller wishes to give a discount to a buyer, he should be able to show that the amount of the discount is justified by the savings effected, and that it does not exceed such savings. In the language of the statute, a seller must be able to show that the discounts or differentials which he allows one buyer and refuses to another buyer "make only due allowance for differences in the cost of manufacture, sale, or delivery resulting from the differing methods or quantities in which such commodities are to such purchasers sold or delivered."

The statute also forbids a buyer or a seller from receiving so-called brokerage on sales or purchases as the case may be.

The Robinson-Patman Act is a part of our antitrust laws, and as previously stated, cooperative associations are in all respects subject to all such statutes.

A point which should be kept constantly in mind is the fact that a cooperative association may become liable under the Robinson-Patman Act, not only on account of discriminatory prices in sales which it makes but also as to its purchases if it is aware of the fact that a seller is discriminating in favor of the association.

6/ International Salt Co. v. U.S., 332 U.S. 392.
7/ 15 U.S.C. 13.

A competitor of a cooperative association who is adversely affected by discrimination arising under the Robinson-Patman Act is entitled to sue a cooperative association for triple damages which he may have suffered, and this is true under the antitrust laws generally.

The Federal Trade Commission Act 8/ prohibits unfair competition in interstate and foreign commerce. Cooperative associations are subject thereto the same as anybody else.

The Fair Labor Standards Act 9/ contains no exemption in favor of cooperative associations, and they are in all respects required to meet the conditions of such Act the same as other business concerns.

I have been attempting to point out that cooperative associations in the conduct of their business are subject to the same rules, regulations, statutes, and restrictions, as other business concerns. It is true that a cooperative which is meeting the requirements for exemption from the payment of Federal income taxes is not required to obtain a clearance from the Securities and Exchange Commission 10/ in the issuance of securities. This exemption may have been based as much on a desire to relieve the Securities and Exchange Commission of unnecessary work as anything else. In the first place, an agricultural cooperative association lives in a gold-fish bowl. In the next place, ordinarily the purchasers of its securities are the persons who organize it and who are identified with its operations, and hence are well informed regarding its character and status. Ordinarily, third persons do not invest in the securities of a cooperative association, and therefore there is less need for supervision of the issuance of securities of cooperative associations than of other types of business enterprises.

On account of the fact that cooperative associations are subject to the same rules and restrictions as other business enterprises, their legal problems are much the same as those of other business concerns. It is true there are some special questions which arise in the operation of agricultural cooperative associations. For instance, it is common practice for cooperative associations to enter into contracts with their members providing for the pooling of agricultural commodities and providing for a settlement or an accounting with the members for the agricultural commodities on an averaging basis. It will be remembered that cooperation is fundamentally a pooling or an averaging proposition - an averaging of expenses, a pooling of prices, etc. A thing which cooperative associations should always keep in mind is the fact that if the marketing contracts and the bylaws of an association specify the particular way in which products are to be handled and accounted for, then they should conform to those requirements. 11/ The fact that the board of directors might be of the opinion that it would be more equitable to make a different arrangement than that provided for by the marketing contract and

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8/ 15 U.S.C. 41.
9/ 29 U.S.C. 201.
10/ 15 U.S.C. 77c.
11/ Cole v. Southern Michigan Fruit Ass'n, 260 Mich. 617, 245 N.W. 534.

bylaws does not in the absence of a specific authorization to the board of directors covering the matter authorize the board of directors to depart from the pooling and settlement arrangements provided for in the marketing contracts and bylaws. 12/

Another point the management of a cooperative should constantly keep in mind is the fact that if the bylaws and marketing contract specify the amounts which may be deducted from the sale proceeds of commodities delivered by members, this restriction must be rigidly observed. The fact that the board of directors might be of the opinion that they needed more money than they were authorized to deduct does not authorize them to make additional deductions. 13/ If a loss is suffered by a member of a cooperative because the board of directors has not observed the bylaws or marketing contract of an association, the directors are personally liable, the same as the board of directors of an ordinary corporation would be.

I believe that in the formation and operation of cooperative associations, we should avoid inflexible doctrines and rigid dogmas. It should be kept in mind that cooperation is based on contracts and agreements, and if producers deem it advisable to cooperate together in ways and by means that appear novel, this should not in and of itself be regarded as a bar to their doing so. After all, the producers should be permitted to cooperate in the way which seems best to them, but management should always keep in mind, as previously pointed out, that it is their job to see to it that the contracts and agreements covering the way in which the producers have agreed to cooperate are meticulously carried out. Of course, by unanimous agreement such arrangements could be altered, but ordinarily no changes in arrangements may be made without the consent of the members concerned.

I want to say just a few words with respect to income taxes and cooperatives. This matter has been quite comprehensively covered by others, and so I will add only a few words. I want to emphasize that if any cooperative association desires to be in a position where it may exclude amounts which it pays as patronage refunds, whether such amounts are paid in cash, in stock, or otherwise, it should have mandatory provisions in its marketing contracts or bylaws requiring it to do so. 14/ By a mandatory provision, I mean one that requires action on the part of the association without action on the part of the board of directors, except possibly with respect to the medium in which payment would be made.

A recent case involving the Railway Express Agency 15/ carries a lesson for agricultural cooperative associations. The Railway Express Agency is a cooperative association formed by some seventy railroads, but it

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12/ Steelman v. County Milk Producers Ass'n, 97 Ore. 535, 192 P. 790.
13/ Silveira v. Associated Milk Producers, 63 Cal. App. 572, 219 P. 461.
14/ American Box Shook Export Ass'n v. Commissioner of Internal Revenue, 156 F. 2d 629; Appeal of Paducah and Illinois Railroad Company, 2 B.T.A. 1001.
15/ Railway Express Agency v. Commissioner of Internal Revenue, 8 T.C. 991.

is doing business with a total of some four hundred. It was organized with a view to operating in such a way that it would have no income taxes to pay from its ordinary operations. It is a nonexempt cooperative organization. It has entered into contracts with each of the railroads with which it does business, under which it is obligated to pay to the railroads on a prescribed patronage basis all amounts over operating and maintenance costs and expenses. It took excessive depreciation in certain years, that is, depreciation in excess of the amounts the Bureau of Internal Revenue regarded as reasonable, and on account of this fact, it was required to pay income taxes on the amount of such excessive depreciation. Of course, the fact that the agency had taken excessive depreciation operated to cut down correspondingly the amounts which it paid to the various railroads on a patronage basis.

Cooperative associations, even though they are exempt from the payment of Federal income taxes, should take depreciation in accordance with the rules and regulations of the Bureau of Internal Revenue. To take excessive depreciation could cost a cooperative association its exemption because an association in taking excessive depreciation in a particular year is taking from the proceeds of that year amounts in excess of the actual expenses incident to that year's business. This, in my opinion, violates one of the requirements for exemption. In some instances, cooperative associations that would not think of taking out of this year's returns the salary of the manager for the next year do in principle the same thing by taking excessive depreciation.

In order for a cooperative association to be eligible for exemption from the payment of Federal income taxes, it is my understanding the association should be under a mandatory obligation to allocate all reserves on a patronage basis which the association takes other than valuation or expense reserves.

RAILWAY EXPRESS AGENCY, INC.

In Railway Express Agency, Inc., v. Commissioner of Internal Revenue, 169 F 2d 193, the Circuit Court of Appeals affirmed the decision of the Tax Court, 8 T.C. 991, Summary No. 39, page 1, holding that this cooperative association, composed of various railroad companies, and which was organized with a view to paying to the railroad companies as payment for services rendered by them all receipts over operating and maintenance costs and expenses, was liable for income taxes on account of excessive depreciation which it had taken on its property. It appeared that no income taxes would have been due but for the fact that this nonexempt organization had taken excessive depreciation, on account of which it was not required to account to the various railroad companies. The Circuit Court of Appeals held, however, that the Tax Court had erred in allowing the taxpayer a credit based on section 26 (c) (1) of the Revenue Act of 1936, which provides for credit in computing income taxes in connection with written contracts restricting payment of dividends.